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IN THE SUPREME COURT OF THE UNITED STATES

DIANA BONTÁ, Director, California Department of Health Services, *Petitioner,*

v.

CHILDREN'S HOSPITAL AND MEDICAL CENTER, a Washington corporation, et al., *Respondents.*

ON PETITION FOR WRIT OF CERTIORARI TO THE CALIFORNIA SUPREME COURT

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

A California statute provides for reimbursement to out-of-state hospitals for care they provide to Medi-Cal recipients. The rate of reimbursement is based on the average paid to California hospitals that enter into contracts with the state. Does this payment scheme violate the Commerce Clause or the Equal Protection Clause?

PARTIES

The petitioner is Diana M. Bonta, Director of the California Department of Health Services. The respondents are Children's Hospital and Medical Center, a Washington corporation; Desert Springs Hospital, Inc., a Nevada corporation; IHC Hospitals, Inc., a Utah corporation, dba Primary Children's Medical Center; Mckenzie-williamette Hospital, an Oregon corporation; Mercy Healthcare Arizona, Inc., an Arizona corporation, dba St. Joseph's Hospital And Medical Center; Merle West Medical Center, an Oregon corporation; National Jewish Center For Immunology And Respiratory Medicine, a Colorado corporation; Peacehealth, a Washington corporation, dba Sacred Heart General Hospital; Rogue Valley Medical Center, an Oregon, Samaritan Health System, an Arizona corporation, dba Desert Samaritan Medical Center, Good Samaritan Regional Medical Center, Havasu Samaritan Regional Hospital, Maryvale Samaritan Regional Hospital, and Thunderbird Samaritan Medical Center; St. Mary's Regional Medical Center, Inc., a Nevada corporation; Washoe Medical Center, Inc., a Nevada corporation; Western Health Network, Inc., a North Dakota corporation, dba Mesa Lutheran Hospital; and Yuma Regional Medical Center, an Arizona corporation

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IN THE SUPREME COURT OF THE UNITED STATES

No.

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v.

CHILDREN'S HOSPITAL AND MEDICAL CENTER, a Washington corporation, et al., *Respondents.*

OPINION OR JUDGMENT BELOW

The opinion of the California Court of Appeal, dated April 15, 2002, is reported at 97 Cal.App.4th 740 (2002). It is reproduced at Appendix A. The order of the California Supreme Court denying review, dated August 14, 2002, is reproduced at Appendix B. 2002 LEXIS 5484.

STATEMENT OF JURISDICTION

The California Court of Appeal opinion implicates the Commerce Clause and the Equal Protection Clause of the United States Constitution. Accordingly, this Court has jurisdiction pursuant to 28 U.S.C. §1257(a) and Rule 10(c) of the Supreme Court Rules.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

1. Article I, § 8, cl. 3 of the U.S. Constitution, provides that "[t]he Congress shall have power . . . 3. To regulate commerce with foreign nations, and among the several States, and with the Indian tribes;"

2. The Fourteenth Amendment to the U.S. Constitution, § 1 states as follows:

> Section 1. All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State where they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the Unite States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

3. Article I, § 7 of the California Constitution, provides for equal protection of the laws. The full text of this provision is reproduced at Appendix C.

4. California Welfare and Institutions Code section 14105.15(i) states as follows:

> Notwithstanding any other provision of law, reimbursement for out-of-state acute inpatient hospital services provided to Medi-Cal beneficiaries shall not exceed the current statewide average of contract rates for acute inpatient hospital services negotiated by the California Medical Assistance Commission or the actual billed charges, whichever is less.

STATEMENT OF THE CASE

This case was brought by 11 out-of-state hospitals that challenged the manner by which California reimbursed them for rendering medical services to California Medi-Cal recipients. The original four-page complaint made no mention of the Commerce Clause or the Equal Protection Clause. The trial court, however, ruled that both constitutional provisions were violated and these rulings, particularly on the Commerce Clause, became the focal point of the Court of Appeal's decision. The California Supreme Court declined to Review the lower court's holding.

When a California resident who is on Medi-Cal travels to another state and needs emergency inpatient hospital care, the out-of-state hospital that provides such care is entitled to reimbursement from the Medi-Cal program. *See* Cal.Code Regs., tit. 22, §51006.[1/] This case concerns the validity of the rate that California pays to those hospitals. The statute that sets forth the applicable rate is California Welfare and Institutions Code section 14105.15(i).[2/] That law provides that California must pay out-of-state hospitals a rate not exceeding the average of what it pays to California contract hospitals.[3/] This formula

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1. As set forth in §51006, California pays for certain other hospital services but emergency care is perhaps the most prominent.

2. Although the statute gives the Department of Health Services (DHS) discretion to pay less than the average, it has chosen to pay hospitals the *maximum* permitted by the statute.

3. Approximately 250 California hospitals negotiate reimbursement rates with the California Medical Assistance Commission (CMAC) for the services they provide to Medi-Cal beneficiaries. These hospitals are generally urban hospitals that

results in a payment rate to out-of-state hospitals that exceeds the rate paid to 58% of California contract hospitals

The heart of the state Court of Appeal's opinion is its conclusion that California's Medi-Cal reimbursement scheme for out-of-state hospitals violates the Commerce Clause. In making this ruling the court engaged in an unwarranted expansion of the meaning of the term "interstate commerce." Contrary to every reported Commerce Clause case, it ruled that a statute violates the negative sweep of the Commerce Clause even when it places no burden on interstate commerce. The court also expanded the law concerning impermissible burdens on interstate commerce. It announced a novel principle that a state must not only refrain from imposing burdens on commerce but must also consider special circumstances of out-of-state facilities. According to the court, these special circumstances might warrant favored treatment of out-of-state facilities over in-state institutions.

REASONS FOR GRANTING THE WRIT

I.

THE COURT OF APPEAL'S DECISION CONFLICTS WITH THIS COURT'S COMMERCE CLAUSE DECISIONS

When California reimburses in-state hospitals it does so in one of two ways: a) The state enters into contracts with hospitals that provide approximately 90% of Medi-Cal services. There is a special commission (CMAC) that negotiates these

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provide 90% of hospital inpatient services under the Medi-Cal program.

agreements with each hospital individually; b) for the balance of the hospitals (mostly small rural hospitals) the state has a complex formula which involves cost data, peer grouping, audits, and other factors. *See* 97 Cal.App.4th 740, 747-748.

California cannot use the payment approaches described above for reimbursing out-of-state hospitals. Most out-of-state hospitals treat Californians only on an episodic basis. In those cases it would be unreasonable to expect California to enter into contracts or apply the complex formulas used for non-contract in-state hospitals. For example, if a hospital in Nebraska happens to treat a single transient California resident in a year, it would be unreasonable to contend that California should negotiate a contract with that hospital[4/] or demand cost data and the opportunity to audit the institution.

To deal with the unique situation of out-of-state hospitals the California Legislature devised a system that is both fair and elegantly simple. It provides that out-of-state hospitals will be paid the average rate paid to California contract hospitals. Welf. & Inst. Code, §14105.15(i).[5/] As we have noted, this results in payments to out-of-state hospitals that

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4. California could hardly negotiate a contract with the 7,500 or so hospitals in this country in anticipation of their treating an occasional California visitor. Nor would it make sense for California to negotiate a contract with a hospital *after* it has already rendered its services to the patient from California.

5. Averaging is a common technique used in many California programs. *See, e.g.*, Cal. Code Regs. tit. 2, §1809 (c)(3), §1865.30 (c)(3), Cal. Code Regs., tit.4, §103, Cal. Code Regs. tit. 5, §15387, Cal. Code Regs. tit.8, §1529, Cal. Code Regs. tit.18, §473, and Cal. Code Regs. tit. 22, §66264.1034.

exceed the rate paid to 58% of California contract hospitals. In many cases, the payments are greater than the hospital would receive from its own state for medicaid services.

In short, because the situation of out-of-state hospitals is different from that of in-state hospitals, the system for paying them is different. It is designed to suit the circumstances. It is different but not invidious, and it does not discriminate against out-of-state hospitals or burden interstate commerce.

The United States Constitution confers authority on Congress to regulate interstate commerce. The Commerce Clause, however, has another aspect. It has a negative sweep, forbidding burdens on interstate commerce that have the effect of discriminating against out-of-state interests in favor of local interests. Where there is a flow of people, goods or services, from one state to another, the receiving state cannot impose a burden on the out-of-state interest in order to further an in-state interest. The doctrine evolved to prevent "economic retaliation" between the states and to control their "mutual jealousies and aggressions." *Baldwin v. G.A.F. Seelig,* 294 U.S. 511, 522 (1935). Here there are no "mutual jealousies" nor is there "economic retaliation," invidious discrimination, or an impermissible burden on interstate commerce.

The California court, however, determined that this Court's decisions compelled a different result. We believe the lower court misinterpreted and improperly expanded the holdings of this Court in the relevant Commerce Clause cases. In all of the cases relied on by the state court, there was a burden placed on interstate commerce. In many cases, local interests benefitted from the imposition of the burden. In other cases the home state was trying to implement a governmental policy at the expense of out-of-state interests. The recurrent theme of these cases, however, was that, whether competition was involved or not, an impermissible burden was imposed on

interstate commerce.

The California court relied on a sentiment expressed on this court over 20 years ago to the effect that jurisprudence in this area was "hopelessly confused," citing *Kassel v. Consolidated Freightways Corp. of Delaware*, 450 U.S. 662, 703 (1981) (Rehnquist, J., dissenting). The state court in this case said, "our high court has yet to provide a fully coherent theory of the negative dimension of the Commerce Clause . . ." 97 Cal.App.4th at 761. The court, however, failed to cure the omission it described. Instead, it misinterpreted this Court's decisions regarding the Commerce Clause and contributed to the confusion in this area of the law.

A few examples illustrate our point. Among others, the California court cited the case of *Camps Newfoundland/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564 (1997), that involved a Maine statute that provided a general exemption from certain taxes for charitable institutions incorporated within the state. However, a more limited exemption applied to camps which catered principally to out-of-state residents. This had the effect of penalizing or burdening out-of-state campers because they would be charged higher fees than in-state campers. The action of the state had the effect of impermissibly burdening interstate commerce.

Let us pause for a moment to examine what effect the Court of Appeal's decision here would have had in the Maine case. Suppose that the Maine law in the *Camps* case provided the identical general tax exemption to all charitable entities. The state court decision in the instant case could be used to argue that the Commerce Clause requires that an even better tax break be given to entities that serve mainly out-of-state persons if justified by specific facts. If, for example, the out-of-state campers had higher travel costs to the Maine camps, under the court's reasoning, the camps catering to these nonresidents

would presumably be entitled to a higher tax break than the ones catering to Maine residents.

In the Maine case all of the camps were located in Maine. The problem arose when a burden was levied affecting out-of-staters coming into Maine. Here, by contrast, the out-of-staters who are coming into the plaintiffs' states, i.e., Medi-Cal beneficiaries, are not burdened at all. They will receive needed services irrespective of the rates paid to plaintiffs. That is the key difference between this case and the *Camps* case.[6]

In *New Energy Company of Indiana v. Limbach*, 486 U.S. 269 (1988), an Ohio statute granted a tax credit against the state motor vehicle fuel sales tax for ethanol produced in Ohio but not to ethanol produced out-of-state. The court said this was discrimination against out-of-state ethanol producers who sold their product in Ohio.

Again, let us look at the effect the Court of Appeal's decision here might have had on the *New Energy* case. Suppose that the Ohio statute described above had granted an identical tax credit against the fuel tax for all ethanol regardless of state of production. The California court's decision could be used by out-of-state ethanol producers to argue that given their unique circumstances (e.g., higher costs of selling their product in Ohio) they should get a more favorable tax credit than Ohio producers of ethanol.

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6. We are aware that this Court has granted certiorari in a Maine case involving the dormant Commerce Clause and the Medicaid program. *Pharmaceutical Research and Manufacturers of America v. Concannon*, No. 01-188. This case is dissimilar to the Maine case and merits this Court's separate consideration.

The Court of Appeal's decision here turns the law set forth in this Court's Commerce Clause cases on its head. It says, in effect, that not only must California's payment system be free of discrimination but that it must *favor* out-of-state hospitals over in-state institutions. The court discusses the various problems faced by out-of-state facilities-- high costs, etc.-- and concludes that California must pay them at a rate which exceeds that which is paid to in-state hospitals. *See, e.g.*, 97 Cal.App.4th at 766.

Moreover, in a further unwarranted expansion of the Commerce Clause, the Court of Appeal indicates that hospitals that are close to California deserve more favorable treatment than that given to more distant hospitals. 97 Cal.App.4th at 760.

The only interstate aspect of this factual situation is the travel of California residents to other states. These travelers are not burdened in any way by California's reimbursement system. They receive needed medical services because federal law requires that hospitals provide them.

If there is no burden on people traveling interstate, it must be determined whether the other parties to the transaction, the out-of-state hospitals, are also engaged in interstate commerce and whether a burden is placed on them. To begin with, those hospitals are not engaged in interstate commerce. They provide their services in their home state, not in California; they do not send in their doctors to or maintain facilities in California. In the absence of a flow of goods or services across state lines and in the absence of an adverse impact on people coming into their respective states, Welfare and Institutions Code section 14105.15, subdivision (i), does not burden interstate commerce.

Furthermore, even if the out-of-state hospitals are

deemed to be engaged in interstate commerce, California does nothing to discriminate against them. The state places no burden on that commerce. The payments do not result in any windfall or advantage for in-state hospitals, and California is not favoring in-state institutions over out-of-state facilities. There is no "purposeful economic protectionism." Regan, *The Supreme Court and Economic Protectionism: Making Sense of the Dormant Commerce Clause*, 84 Mich. L. Rev. 1091, 1092 (1986). California uses one methodology to pay in-state contract hospitals, it uses another to pay non-contract in-state facilities, and a third to pay out-of-state hospitals. Each payment system is designed to suit the particular circumstances of the group being paid.

If it is determined that there is an impact on interstate commerce, the effect is incidental and is far outweighted by the benefits of the payment system. Accordingly, the statute meets the criteria set forth in *Pike v. Bruce Church,* 397 U.S. 137, 142 (1970).

This Court's decisions do not support the conclusion of the state court that the Commerce Clause may be extended to compel higher payments to out-of-state hospitals than to in-state hospitals. As we have pointed out, 90% of hospital inpatient services provided to Medi-Cal patients in California are provided at hospitals that negotiate a reimbursement rate with the state. Out-of-state hospitals are paid the average of these rates. This results in their being paid at a rate higher than that received by 58% of in-state contract hospitals. The state court, however, hold that this rate is not high enough, that the out-of-state hospitals must receive even more, based on their costs and other factors. This Court should grant certiorari to review this startling extension of the Commerce Clause.

After setting forth the various findings and conclusions of the trial court (97 Cal.App.4th at 759-760), the

Court of Appeal remarked that the hospitals in this case are close to California and are more adversely affected by California's payment system than more distant hospitals. *Id.* at 760. Without saying so explicitly, the court apparently advocates disparate treatment of hospitals close to California versus hospitals located in areas that do not border California. There is no rule of law that would enable California to treat hospitals "close to the California border" one way and more distant hospitals another. For one thing, how close is "close to the California border"? Five miles? Fifty miles? Must California make graduated payments based on distance from California? For another, should California pay more money to border hospitals than to others simply because they treat more Medi-Cal patients? Such discrimination based on volume or proximity would clearly be invalid.

In short, the Court of Appeal has concluded that it is not sufficient that California pays out-of-state hospitals more than it pays over half the contract hospitals within the state. The court concluded that out-of-state hospitals should be *favored* over in-state institutions because of such factors as cost-mix, volume, lack of appeal procedures, and effect on their non-Medi-Cal business. Nothing in Commerce Clause jurisprudence justifies such favored treatment.

The Court of Appeal decries the lack of procedures for out-of-state hospitals to challenge the adequacy of reimbursement rates, indicating that this impermissibly burdens interstate commerce. But the fact is that there is no reason for administrative procedures to challenge payment rates. The rates are fixed by statute. DHS obtains the most recent statewide average contained in CMAC's report to the Legislature. Welf. & Inst. Code, §14165.9(d)(1). That number is applied automatically whenever an out-of-state hospital treats Medi-Cal recipients. There is nothing to appeal, nothing to challenge. (There is an administrative procedure to correct arithmetic

mistakes or a clerical errors.)

And why should out-of-state hospitals have administrative remedies that are not available to California contract hospitals? In fact, there are no administrative procedures that California contract hospitals can invoke to challenge payment rates. Since they negotiate a rate, there is nothing to challenge and such procedures would be superfluous. As is the case with out-of-state hospitals, the rate is set and that's it. Put another way, out-of-state hospitals are in the same position as California hospitals which provide 90% of hospital inpatient services under Medi-Cal. In both situations administrative procedures to challenge rates would be superfluous. Again, the state court improperly extended the reach of the Commerce Clause, commanding that out-of-state hospitals receive favored treatment over the majority of in-state hospitals.[7]

Footnote 15 (97 Cal.App.4th at 764) deserves special attention. In that footnote the court suggests that California can enter into contracts with "the relatively few large hospitals in nearby regions of adjacent states." As we have noted earlier, this is expressly forbidden by statute. Welf. & Inst. Code §14086(b). Second, requiring such procedures would discriminate against hospitals that are more distant. Moreover, there are no standards to determine which hospitals would be suitable for contracts. What is a "large hospital"? How close to California must a hospital be to qualify for contracting? The court suggests those hospitals would be willing to provide cost

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7. Appellate procedures do make sense with respect to the California hospitals that are not on contract. Those hospitals often have disputes with the Department concerning cost data, audit results, overpayments, underpayments, etc. and procedures are necessary to resolve those differences.

data and submit to audits. There is absolutely nothing in the record to support this suggestion. Moreover, the court offers no alternative in the event the hospitals refuse to provide such data or to submit to audits.

Hospitals in all states must treat patients who need emergency care. 42 U.S.C. §1395dd. When a hospital in Montana, for example, treats a California resident, the service is rendered in Montana. The hospital is not competing with any California hospitals for the business of providing services to Medicaid patients. The Montana hospital is providing services that it is obligated to provide and it is doing so within its own state. No California hospital gains any advantage over the Montana hospital by virtue of the amount paid by California to the Montana hospital. The court below conceded this point.[8/]

To avoid the ineluctable conclusion that in-state interests are not favored over out-of-state interests, the court shifts the focus of the debate. Instead of limiting the focus to Medicaid patients- which is the subject of this lawsuit- the court states that a number of the plaintiff hospitals compete for non-Medi-Cal patients, i.e., fee-paying patients, and that their under-compensation for Medi-Cal patients places their other business at a competitive disadvantage. 97 Cal.App.4th at 766. There are a number of responses to this attenuated position.

1) The hospitals in this case never presented evidence showing that their non-Medicaid business was adversely affected by California's Medi-Cal payments and there are no trial court findings to support this assertion. Indeed, the Court

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8. Curiously, the lower court devotes virtually its entire attention to hospitals that are in states contiguous to California. We have no idea what principles or analysis the court would apply to the Montana hospital in our hypothetical.

of Appeal cites nothing to support this premise. The court says the only way out-of-state hospitals can compensate for their unreimbursed costs relating to Medi-Cal "is either to charge other patients more" or accept lower profit margins. *Id.* There is nothing in the record or any trial court finding to support that proposition; it is nothing more than unsupported speculation by the court.

2) Medi-Cal patients at Washoe County Hospital in Reno, the biggest of the plaintiff institutions, comprise only one tenth of one per cent (.01%) of the hospital's patient census. It is hard to believe that this negligible percentage could have any meaningful impact on the hospital's revenue from other sources.[9/] It is thus misleading for the court to characterize the payments made as "under-compensation."

3) The court mixes apples and oranges. The focus in this case is on Medi-Cal, i.e., how California pays out-of-state hospitals for providing care to Medi-Cal recipients versus how California pays California hospitals when they provide such care to Medi-Cal patients. The question is whether in-state hospitals gain some kind of advantage over out-of-state hospitals when both treat Medi-Cal patients. Apples to apples means comparing Medi-Cal to Medi-Cal. It does not mean examining whether Medi-Cal reimbursement rates paid to hospitals close to California have an impact on the hospitals' competition with California hospitals for fee-paying patients. Once again, the Court of Appeal has elasticized the Commerce Clause in a manner that cannot be reconciled with this Court's decisions.

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9. Washoe serves more Medi-Cal patients than any of the other plaintiffs. If its percentage is one tenth of one per cent, the percentage for the other hospitals, which are farther from California, is likely to be even lower.

II.

THE COURT OF APPEAL WRONGLY NARROWED THE MARKET-PARTICIPATION EXCEPTION

In a number of cases this Court has articulated what is known as the market-participation exception. The California court in this case failed to apply that principle accurately. That exception states that when a state is involved in purchasing or selling goods or services, it may favor its local citizens without running afoul of the Commerce Clause. "If a state is acting as a market participant, rather than as a market regulator, the dormant commerce clause places no limitation on its activities." *South Central Timber Dev. v. Wunnicke,* 467 U.S. 82, 93 (1984). This exception means that even if one accepts the lower court's conclusion in this case that the payments by California and its administrative procedures tend to favor California hospitals over out-of-state hospitals, that favoritism is permissible.

The point is illustrated by the Ninth Circuit case of *Big Country Foods v. Board of Education*, 952 F.2d 1173 (9th Cir. 1992). In that case the state of Alaska received federal funds for the purchase of milk for school children. Alaska had a state statute requiring schools receiving state funds to buy dairy products produced in the state of Alaska if the price was no more than 7% higher than products of like quality harvested outside the state. *Id.* at 1175. Pursuant to the statute the Anchorage school district purchased milk from an Alaskan supplier even though the cost was higher than the bid submitted by an out-of-state supplier. The Ninth Circuit noted, "[t]here is no question that Alaska's preference statute discriminates against interstate commerce.... Neither Alaska nor the federal appellees cites any reasons for the statute's existence other than economic protectionism for Alaska's milk harvesters." *Id.* at

1177. Nevertheless the court held that, because of the market-participation exception, there was no Commerce Clause violation.

The Ninth Circuit noted the series of United States Supreme Court cases that establish this exception. For example, in *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794 (1976), this Court stated, "[n]othing in the purposes animating the commerce clause prohibits a state, in the absence of congressional action, from participating in the market and exercising the right to favor its own citizens over others." (*Id.* at 810.) Similarly in *Reeves, Inc. v. Stake*, 447 U.S. 429 (1980), this Court upheld a South Dakota law which gave favored treatment to South Dakota residents in the purchase of cement. *See also White v. Mass. Council of Construction Employers, Inc.* 460 U.S. 204 (1983).

In *Big Country* the Ninth Circuit also observed that the fact that federal funds were involved did not change the market-participation exception. 952 F.2d at 1180. The court concluded that Alaska was directly involved in the market. It stated,

> In implementing its program to buy milk for its schools, Alaska commits itself to the terms of its annual milk supply contracts, including the obligation to pay for the milk. It also administers the acquisition and disbursement of milk funds through a maze of credits and reimbursements. Federal funds provide the wherewithal to make the milk purchases, but it is Alaska that is the direct participant in the market. Accordingly the market participant exception applies.

Id. at 1180.

Similarly, in the instant case, it is the State of California that participates in the purchase of medical services for those of its residents who require acute inpatient care when out-of-state. Thus, even if this Court concludes that this activity constitutes engaging in interstate commerce, the market-participation exception applies.

The Court of Appeal states that the exception is inapplicable because "the state itself is not a consumer of the service in question, nor does it pick and choose service providers"? 97 Cal.App.4th at 768. This statement enunciates a new principle. The fact that the state does not purchase services for governmental purposes does not mean the exception is inapplicable. The state is purchasing medical services for its citizens both within California and in other states. In this respect the facts here are similar to those in the *Big Country Foods* case. In both cases the state was purchasing something for its citizens– here it is medical services; in *Big Country Foods* it was milk for Alaska's schoolchildren.

The Court of Appeal held that the exception was inapplicable here because "[the state] is not participating in an open market."[10/] *Id.* Here again the court was unfaithful to the decisions of this Court. There is nothing in the case law that requires an "open market" for the exception to apply. When a state steps in and imposes special burdens or requirements, it alters the so-called "open market." This was true in the *Big Country Foods* case. It was also true in *Hughes v. Alexandra*

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10. On the one hand, the Court of Appeal says that the state is not competing in the marketplace but rather acting as a regulator. 97 Cal.App.4th at 768. On the other hand it maintains that the alleged under-compensation by California has an adverse effect on competition between in-state and out-of-state hospitals. *Id.* at 766. The court cannot have it both ways.

Scrap Corp., 426 U.S. 794 (1976). In that case the state of Maryland imposed different documentation requirements on out-of-state companies who sought a bounty for junk cars delivered to in-state processors. Maryland clearly was "not participating in an open market." Indeed, it was altering the conditions of the open market. This court noted that "[the] practical effect was substantially the same as if Maryland had withdrawn altogether the availability of bounties on hulks delivered by unlicensed suppliers to licensed non-Maryland processors." *Id.* at 803, n.13. Despite this interference with the market, the Court held that the exception applied.

III.

THE STATE COURT OPINION DOES NOT REST ON AN INDEPENDENT STATE GROUND

Respondents may argue that the Court of Appeal opinion stands, in part, on an independent state ground and this Court should therefore deny the petition. The lower court did say that the statute in question violates both the state and federal Equal Protection Clauses. However, the court failed to make the "plain statement" required to defeat jurisdiction. The state court simply said the state's "conduct therefore infringes respondents' rights under the equal protection clauses of the state and federal Constitutions." 97 Cal.App.4th at 771. This does not constitute the "plain statement" required by *Michigan v. Long*, 463 U.S. 1032, 1042 (1983), for the state court decision to rest on independent and adequate state grounds.

The principal holding of the state court in this case is not based on state grounds. It is based on the conclusion that the state statute violates the Commerce Clause. On the equal protection issue, the court acknowledged that "[t]he provisions of the California Constitution guaranteeing equal protection . . . are 'substantially the equivalent of the equal protection

clause of the Fourteenth Amendment. . . .' " 97 Cal.App.4th at 769. Moreover, the court relied almost exclusively on federal cases, not state cases, in its equal protection analysis. Under these circumstances, there exists no true independent and adequate state ground barring certiorari. *See New York v. Class*, 475 U.S. 106, 109 (1986) ["The opinion of the New York Court of Appeals mentioned the New York Constitution but once, and then only in conjunction with the United States Constitution."]; *Delaware v. Prouse*, 440 U.S. 648, 653 (1979); *Zacchini v. Scripps-Howard Broadcasting Co.*, 433 U.S. 562, 568 (1977).

IV.

THE STATE COURT OPINION CONFLICTS WITH THIS COURT'S DECISIONS ON EQUAL PROTECTION.

The Court of Appeal acknowledged that there is no fundamental interest involved here and that the rational basis test applies. It then ruled that there was no rational basis for California reimbursement system. In doing so it established new parameters for that test. Contrary to existing law, it shifted the burden of proof to the state and ruled out any considerations of practicality, cost, or administrative necessity.

The rational basis test requires us to examine the state purpose and whether the legislation under scrutiny is a reasonable method of achieving that purpose. *Board of Trustees of the Univ. of Alabama v. Garrett* 531 U.S. 356 (2001). The state purpose here is to reimburse out-of-state hospitals for taking care of California residents who are on Medi-Cal. The question is whether section 14105.15(i) is a reasonable way to do that.

The Court of Appeal conceded that the state is not required to achieve mathematical precision in its payment

scheme. 97 Cal.App.4th at 769. However, it then concluded that California's failure to obtain cost data for out-of-state hospitals means there is no rational basis for our payment scheme.

The Court of Appeal again appears to be saying that hospitals close to California deserve special treatment. *Id.* at 770. The court does not deal with more distant hospitals and provides no guidance as to how close a hospital must be to California to merit payments higher than those paid to California hospitals.

The lower court concludes that "DHS has failed to demonstrate that its differential treatment of respondent hospitals on the basis of their location out of state is rationally related to a legitimate governmental purpose." Contrary to existing law, the court placed the burden on the state to demonstrate that the legislation has a rational basis. "Rather, the burden is upon the challenging party to negative 'any reasonably conceivable state of facts that could provide a rational basis for the classification.' [Citations.]" *Garrett*, 531 U.S. at 367.

Whether or not the state had the burden to show rational basis, the fact is that it did make such a showing. It demonstrated that the situation of out-of-state hospitals (both those close to the California border and more distant ones) poses special problems. For that reason the California Legislature designed a payment system that is different from that used for in-state facilities but that is practical and fair and takes into consideration the special circumstances of out-of-state institutions.[11/] "The problems of government are practical

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11. In a case decided this year, the Fourth Circuit considered an equal protection attack on a Virginia statute that

ones and may justify, if they do not require, rough accommodations--illogical, it may be, and unscientific. [Citation.] A statutory discrimination will not be set aside if any state of facts may reasonably be conceived to justify it. [Citation.]" *Dandridge v. Williams,* 397 U.S. 471, 485 (1985).

The Court of Appeal's ruling that administrative and budgetary considerations merit no consideration is at odds with this Court's holdings. In *Weinberger v. Salfi,* 422 U.S. 749, 780 (1975), the Court discussed a statute and noted that "any imprecision from which it might suffer was justified by its ease and certainty of operation." It also stated that a payment scheme may take into account "the expense and other difficulties of individual determinations." *Id.* at.777; *see also Geduldig v. Aiello,* 417 U.S. 484, 495-496 (1974); *Colorado Health Care v. Colorado Department of Social Services,* 842 F.2d 1158, 1168, 1169, n. 9 (10th Cir. 1988) [costs involved in implementing a program are a valid consideration]; *Mississippi Hosp. Assoc. v. Heckler,* 701 F.2d 511, 518 (5th Cir. 1983). The state court in this case wrongly rejected these principles.

The system designed by the California Legislature has a rational basis. It avoids the problems created by attempting to apply to out-of-state hospitals the methods used to pay in-state hospitals. At the same time it assures that out-of-state institutions will receive a fair and generous payment. In some cases the system may pay an out-of-state hospital more than it would be paid by its home state; in other cases, it may pay less.

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treated tobacco manufacturers in different ways. The court sustained the statute, noting, "[e]ven though the tobacco manufacturers are treated differently, the differences in treatment are related to their different circumstances, allowing the state to accomplish its legitimate purposes." *Star Scientific Inc. v. Beales,* 278 F.3d 339, 352 (4th Cir. 2002) .

On the whole, however, the system is equitable. At the very least, it has a rational basis and is consistent with equal protection principles.

As this court recently stated, "[w]here a group possesses 'distinguishing characteristics relevant to interests the State has the authority to implement,' a State's decision to act on the basis of those differences does not give rise to a constitutional violation. [Citation.]." *Garrett,* 531 U.S. at 366-367. Plaintiffs never met their burden in this case. They never showed there were no conceivable facts that would support the conclusion that the state statute had a rational basis. Accordingly, the court below was wrong in concluding that there was an equal protection violation.

V.

THE QUESTION PRESENTED IS OF NATIONAL IMPORTANCE

All states face the problem of reimbursing out-of-state facilities for care rendered under the circumstances presented here. The payment systems used vary among the states. In states where those systems differentiate between in-state hospitals and out-of-state hospitals, the California decision could jeopardize those reimbursement schemes. Health facilities across the country are in a constant quest for additional revenue, and the instant California decision may be used to further that goal at the expense of effective government.

CONCLUSION

The state Court of Appeal failed to follow this Court's decisions, altering and impermissibly expanding the standards applying to Commerce Clause and equal protection jurisprudence. The decision disregards the law developed by

this Court and has the potential for disrupting many state Medicaid programs. The California system for reimbursing out-of-state hospitals imposes no burden on interstate commerce and does not discriminate against out-of-state institutions. To the extent the payment system might otherwise be deemed burdensome, the statute at issue qualifies for the market-participation exception.

Finally, the state court incorrectly applied this Court's rulings on the Equal Protection Clause. Had it done so correctly, it would have been compelled to find that there is a rational basis for California's reimbursement scheme.

For the reasons stated, this petition for certiorari should be granted.

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